

Budget Tidbits... just the facts

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Senate Ways & Means

Budget Brief #1 (1/12/06)

Constitutional Rainy Day Fund – An Idea Whose Time Has Come

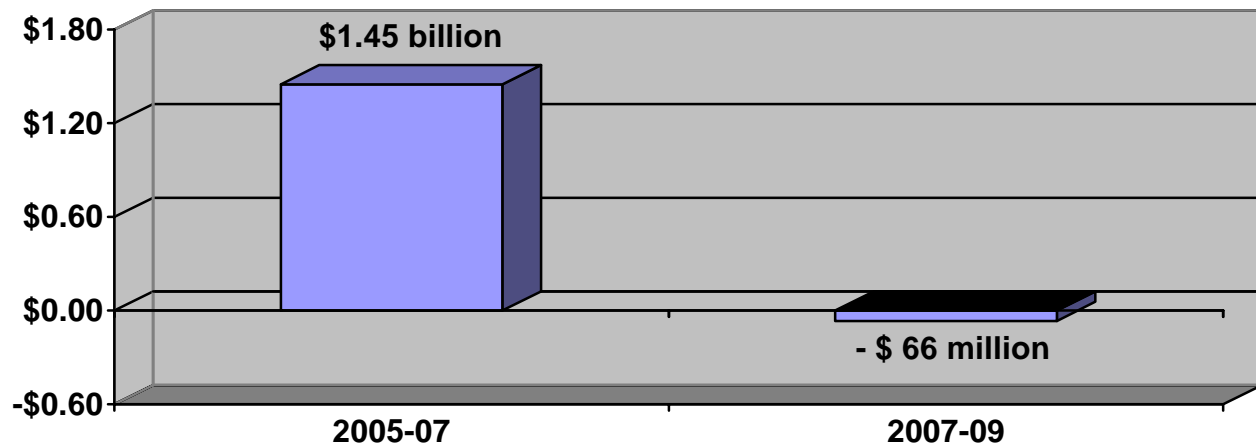
“One of the most effective ways of dealing with cyclical crises in state revenue could be a constitutionally-mandated ‘rainy day fund.’ . . . [A] rainy day fund can help reduce the need for large cuts in state government spending during economic down times and reduce the need for tax increases when revenues decrease. Just as with a family budget, savings during high revenue periods can help offset problems when income decreases precipitously.”

(Gates Tax Structure Study Commission, November 2002 Final Report – p. 84)

I. The Need for a Protected Reserve

- The state’s present situation illustrates why a constitutional rainy day fund is needed.

The Vanishing Reserve



*Source: OFM 6 year outlook, 12/20/05

- State revenues are booming, resulting in the largest reserve in history. Yet, according to the Governor’s own budget office, the reserve will be completely gone in two years.
- This despite robust assumptions of more than 10% revenue growth next biennium.
- Something is fundamentally wrong if during a healthy growing economy the state’s largest reserve in history is spent in two years, leaving none for the inevitable economic downturn.

II. Senate Joint Resolution 8222: A Common Sense Solution

A. Automatically puts away 1% of revenue annually

- Requires 1% of yearly general state revenues (1% of biennial revenues) automatically be deposited in a constitutionally-created rainy day reserve fund.

- Equals roughly \$102 M a year currently (\$204 M a biennium)
- Legislature can always appropriate more money into rainy day fund.

B. Requires 3/5 vote to tap fund in good economic times

- Generally a 3/5 majority of each legislative branch is required to tap into the fund.
 - If the reserve grows above 10% of annual general state revenue (5% of biennial revenue), a simple majority can tap into the amount above the 10% threshold. The implementing statute provides the first use of such excess funds is to pay down existing unfunded pension liabilities.

C. Simple majority may tap fund in bad economic times

- A simple majority of the legislature can tap the fund if forecasted employment growth for a fiscal year is projected to be less than 1%. No restrictions on amount of tapping.
 - The employment growth trigger is a safeguard to ensure funds are there when a rainy day occurs. A revenue growth trigger, based on slow revenue growth, could be manipulated via tax cuts or fund shifts to trigger release of the funds, defeating the purpose of ensuring the funds are there for a rainy day. Employment growth is not subject to such artificial manipulations.

D. How would this have worked in the past?

- 1% Employment Growth Good Proxy for Recession – The trigger is an excellent indicator for when the fund would need to be tapped due to an economic downturn. The state has experienced less than 1% employment growth since 1970 in these years:
 - 1970-71 – Boeing “Turn Out the Lights” Recession
 - 1981,82,83 – Boeing Recession / Legislature put sales tax on food
 - 2002,03,04 – Post 9/11 Recession / Legislature spent most of reserve before downturn, ending up selling portion of future tobacco revenue stream for 1 time cash payment
- Had the constitutional-rainy day fund been in place, money would have been put away, protected from premature raiding, and been able to be tapped at just the right time to avert tax hikes & protect services.

III. Bi-Partisan Philosophical Support Seems to Be Present

Governor Gregoire

- "We spend when we have a surplus and we struggle to make painful cuts when the economy slumps," the governor said. **"It is time we even out the road."** (*Seattle Times* - 1/11/06, quoting the *State of the State*)
- "I know the economy sometimes feels like a roller coaster," Gov. Gregoire said. **"We have a responsibility to help smooth out the ride."** (12/8/05 press release)
- "We can avoid tax increases to support existing state programs if we spend wisely and save," the governor said. "That is the stability that I want in state government[.]" (12/8/05 press release)

- “The economy is cyclical. It is never a flat line, and **I’m interested in positioning this state to weather a down cycle as much as we enjoy an up cycle.**” (11/4/05 press release)
- "I intend to be careful to protect education and other vital state programs by looking not just at the present, but at what we will need tomorrow to sustain these programs." (11/4/05 press release)

Senate Majority Leader Brown

- "We've been struggling with this whole issue of sustainability in the state budget. Were we to cut now, that would simply set us up for another round of either spending cuts or tax increases," Brown said. **"Let's try and even out that boom-bust cycle."** (Seattle PI - 1/4/06)
- Member of Gates Tax Study Commission, which endorsed constitutional rainy day fund.

Senate Ways & Means Chair Prentice

- “This session, we’ll be looking to create new opportunities now and **safeguard our ability to pay for our public commitments later.**” (12/20/05 press release)
- “We should only adopt new policies that make future budgets easier to build, not harder.” (Ways & Means Hearing – 9/19/05)

Several Senate Democrats have sponsored or co-sponsored similar bills recently

- Sens. Fairley, Rasmussen, Sheldon & Shin signed onto SJR 8204 (2003).
- Sens. Franklin, Kline, & Kohl-Welles signed onto SJR 8203 (2005).

Bottom Line

The Constitutional Rainy Day Fund is a common-sense idea whose time has come. With bi-partisan support, the legislature should act to ensure a healthy reserve is present for the inevitable next economic downturn, so as to avoid the need for tax increases or large cuts.

This is the most important fiscal legislation before the legislature this year.